

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
EQUITY REAL ESTATE**

September 16, 2005~~August 15, 2005~~

This Policy is effective immediately upon adoption and supersedes all previous equity real estate portfolio policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Equity Real Estate Investment Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest [risk-adjusted total](#) rate of return possible is the strategic objective of the Portfolio. The objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Equity Real Estate Portfolio shall be managed to accomplish the following:

- A. Provide diversification;
- B. Preserve investment capital;
- C. Generate attractive risk-adjusted rates of return for the System;
- D. Provide a hedge against inflation;
- E. Provide stable cash flow from operations;
- F. Provide [appreciation](#) potential; and

- G. Consider solely the interest of the System's participants and beneficiaries in accordance with California State Law.

The Equity Real Estate Portfolio is divided into two segments; the Core Portfolio and the Non Core Portfolio, based on risk and return characteristics. The strategic objective of the Core Portfolio is to produce stable current [income](#) and market level returns commensurate with a low-to-moderate level of risk. The strategic objective of the Non Core Portfolio is generally to produce higher returns than the Core Portfolio, thereby increasing the overall performance of the Equity Real Estate Portfolio, subject to an incrementally greater amount of risk. Allocations to the Core and Non Core Portfolios shall be made to maximize the overall return to the Equity Real Estate Portfolio while mitigating risk.

III. PERFORMANCE OBJECTIVE

- A. Exceed (after fees) a minimum [real rate of return](#) of 5.0%; and
- B. Exceed (before-fees) the [National Council of Real Estate Investment Fiduciaries Index](#) ("NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

The asset allocation target and range for the Portfolio shall comply with the guidelines included in the Strategic Asset Allocation Policy, as periodically adjusted by the Board and the Delegation and Approval Guidelines for Real Estate Investments. Adjustments from actual to target allocation shall be implemented within a time frame consistent with the provisions set forth in the Strategic Asset Allocation Policy.

- A. Allocation of the Equity Real Estate Portfolio between Core and Non Core Portfolios:

The Core Portfolio will comprise 30 - 80% of the target allocation to the Equity Real Estate Portfolio. The remaining 20 - 70% of the target allocation to the Equity Real Estate Portfolio will comprise the Non Core Portfolio. The allocation ranges for the Core and Non Core Portfolios may also be adjusted from time to time for risk management purposes.

As investments in the Non Core Portfolio mature, their characteristics may migrate towards a more Core-like profile. The Real Estate Consultant or Staff or both shall monitor the Equity Real Estate Portfolio for instances when changes in the

classification of investments from the Non Core to the Core Portfolio are warranted. The Real Estate Consultant or Staff or both will make recommendations to the Investment Committee for approval of such reclassifications.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Prudent Expert Standard

The selection of real estate investments shall be guided by the "prudent expert" standard, embracing the prudent decision making process typically employed by experts in the areas of real estate acquisition, development, operation, disposition, and portfolio management.

B. Diversification Principle

The principle of diversification in portfolio theory is defined as "The reduction of risk without a corresponding reduction of return." This shall be accomplished through the investment of capital among a variety of management organizations, strategies, asset types, and sub-markets, based on the guidelines contained herein. The Portfolio shall be diversified within reasonable tolerance bands regarding investment strategies, property types and locations, and investment structures, among other factors.

C. Renewable Energy and Sustainable Buildings

CalPERS encourages the prudent use of sustainable building development methods, and operational practices when reasonable and economically feasible. Consideration shall be given to the use of renewable energy technologies, recycled and renewable building materials, air and water conservation technologies and practices, and efficient waste, recycle and disposal technology and practices.

VI. PERMISSIBLE INVESTMENTS

A. Equity real estate investments may include direct or [indirect](#) equity investments in real estate, including all rights and interests incident thereto. The following is a list of such investments:

1. Interests in corporations, partnerships and other entities whose primary business is the acquisition, development and operation of real property including publicly-traded or private [Real Estate Investment Trusts \("REITs"\)](#) and [real estate operating companies \(aka "PREES"\)](#). Investments in REITs

and real estate operating companies shall be made subject to the Statement of Investment Policy for Enhanced Core Index Public Real Estate Equity Securities (Enhanced Core PREES), Statement of Investment Policy for Extended Market Public Real Estate Securities (Extended Market PREES), Guidelines and Procedures (Section VI.F.4);

2. [Co-investment](#) with other institutional investors;
 3. [Participating](#) or [convertible participating mortgages](#) or other debt instruments convertible into equity interests in real property based on investment terms (and not merely by foreclosure upon default). Investments in debt with equity features shall be made subject to the Statement of Investment Policy for Hybrid Debt Investments;
 4. Options to purchase real estate, [leaseholds](#), and [sale leasebacks](#), subject to the Statement of Investment Policy for Sale-Leaseback Investments; and
 5. All other real estate related securities such as lower or unrated tranches of pre-existing securitized or structured debt instruments such as mezzanine debt, with equity features.
- B. [Leveraged equity investments](#) are permissible subject to the Statement of Investment Policy for Equity Real Estate [Leverage](#).
- C. Joint venture investments are permitted. Joint venture equity partners may include both institutional investors (passive investors) and owner-developer/manager entities (active investors). Joint venture investments shall be subject to the provisions set forth in the Statement of Investment Policy for Equity Real Estate Joint Ventures.
- D. Properties and reversionary interests in properties may be acquired subject to [ground leases](#).
- E. International investments undertaken through the Core portfolio may be accounted for through the Core portfolio for allocation purposes and must adhere to the Statement of Investment Policy for International Equity Real Estate Investments. International investments within the Core portfolio will be subject to appropriate alignment of interests and risk-adjusted returns. Partners must receive specific written approval for international investments subject to approval of the Senior Investment Officer. Strategies,

including international investments by Core partners shall be stated in their respective Annual Plans.

International investments are permitted for the Non Core Portfolio given appropriate review of the experience and strength of potential investment management organizations, and the real estate and capital markets, practices, and laws of countries selected, among other factors.

F. Restrictions and Prohibitions

On occasion, the System may determine that certain investment strategies are not suitable. Appendix I of this Policy contains a list of prohibited investment programs.

VII. REAL ESTATE VALUATION

The System's investments in [equity real estate](#) shall be valued at least annually on a [fair market value](#) basis. In certain circumstances, when it is inappropriate or not possible to value investments at market, an alternate method of valuation may be used. For example, development projects are generally carried at cost for an appropriate period of time. Real estate valuations shall be governed by the Statement of Investment Policy for Equity Real Estate Appraisal and Valuation.

VIII. STRATEGIC AND ANNUAL PLANS

A. Strategic Plan

A Strategic Plan shall be prepared for the Equity Real Estate Portfolio ("the Strategic Plan"). The Strategic Plan will set forth the System's long-term objectives for investment and management of the Portfolio. The Plan shall include an implementation plan based on the Portfolio's sub-classifications, the Core and Non Core Portfolios; property sub-divisions of the Core Portfolio (i.e., the Apartment, Office, Retail, and Industrial); and various investment programs contained within the Non Core Portfolio. The Strategic Plan shall be updated periodically, as necessary.

B. Annual Plan

An Annual Plan shall be prepared for the Equity Real Estate Portfolio detailing the current status of the Portfolio and outlining expectations or initiatives for the coming year, in-line with the Strategic Plan. The Annual Plan shall be based on input from each of the System's investment management organizations as well as

other market driven factors. The Annual Plan may also contain an overview of emerging real estate opportunities.

IX. PERFORMANCE MEASUREMENT

A comprehensive performance measurement report for the Portfolio shall be prepared on a quarterly basis ("the Performance Report"). The Performance Report shall contain historical time-weighted and/or internal rates of returns for each of the System's investment accounts, as appropriate. Additionally, a comparison shall be made of each investment's actual internal rate of return to its objective. Returns shall be aggregated, along with information on investment attributes, on a total portfolio basis and based on the various sub-classifications of the Portfolio, as outlined in this document. Comparisons shall be made of actual results to the Portfolio benchmark, investment parameters, and other guidelines or objectives contained in this and other policy statements relating to the Portfolio. Furthermore, the Performance Report shall address the impact of the Portfolio performance on the System's total portfolio return. Lastly, the Performance Report shall contain information on new significant events.

X. SELECTION, MONITORING, EVALUATION, AND TERMINATION OF INVESTMENT MANAGEMENT ORGANIZATIONS

A. Selection of Investment Management Organizations

The System seeks to retain investment management organizations possessing superior capabilities in locating, negotiating, monitoring and disposing of investments. The System shall establish and document specific relevant criteria for each Management firm before they are selected to establish the basis on which the selection will be made. Selection of Management is critical to the success of the Portfolio.

Management firms and/or Partners shall be selected by the System pursuant to the Delegation and Approval Guidelines. Staff may recommend the use of Management firms and/or Partners or multiple firms for a specific investment program. Upon selection, the Staff and Management firms and/or Partners/Partner(s) selected will refine and implement the investment program for the strategy, as outlined in policy documents. Management firms and/or Partners shall prepare and implement approved Annual Investment Plans, manage System assets, and provide quarterly reports in accordance with System standards.

If the use of commingled funds is selected, Staff shall perform an analysis of appropriate available commingled funds with the assistance of the Real Estate Consultant as appropriate. Investments in commingled funds may involve the use of investment managers not previously approved by the Investment Committee.

Pursuant to the above objectives, prospective Management firms and/or Partners shall be evaluated for selection based upon, but not limited to the following criteria:

1. The suitability of the organization's investment plan relative to the Equity Real Estate Portfolio's investment guidelines and objectives;
2. The quality, stability, integrity, and experience of the management team;
3. The ability and willingness of the organization to dedicate sufficient resources and personnel to optimally manage the System's investments;
4. The reasonableness of investment terms and conditions including provisions to align interests of management and the System; and
5. The appropriateness of management controls and reporting systems, among other factors.

B. Asset Management

Management firms and/or Partners shall represent the System's interests in asset management decisions and oversee or provide daily property management services, as expertise and organizational structure allows, and act in a fiduciary capacity. The System shall give Management firms and/or Partners the appropriate delegation of authority. Management firms and/or Partners shall provide suitable measures of accountability to the System.

The System shall require that each investment have specific investment program parameters and contractual relationships with the Management firms and/or Partners selected.

The Real Estate Unit and/or the Real Estate Consultant (as appropriate) shall develop investment program parameters. The

parameters developed shall be subject to approval by the Investment Committee, if it is a new sector where delegation has not been given to Staff. Important program parameters include the following:

1. Program size - funds allocated to the market segment;
2. Timing - target date for investment of allocated funds;
3. Diversification - target allocation of funds among geographic regions and sub markets within the market segment as appropriate;
4. Investment guidelines - specification of the investment guidelines for acceptable investments within the market segment; and
5. Asset management - specification of the expected value-enhancing activities that shall result in maximizing returns to the System.

The Real Estate Unit and the System's legal counsel shall have the joint responsibility for developing the contractual relationship. Generally, the contract standards shall adhere to the form established by the System's other existing real estate contracts to the extent possible.

Unless specifically delegated in the contract, the Delegation and Approval Guidelines shall govern the decision-making in Portfolio investments.

C. Monitoring, Evaluation, and Termination of Investment Management Organizations

The primary objective of ongoing monitoring and evaluation of investment management organizations is to ensure that each manager provides satisfactory performance of their duties and complies with various obligations set forth in their contract.

The System's investment management organizations shall be monitored and evaluated on an ongoing basis based on their performance relative to stated objectives and benchmark, and the performance of firms managing similar investments in the marketplace. Additionally, investment management organizations shall be monitored for compliance with investment guidelines, policies, and procedures of the System and other contractual

provisions. Consideration shall also be given to the financial strength of the investment management organization, the level of client service given the System and changes within the managing organization; for example, the continuity of personnel assigned to the System's investments shall be reviewed, among other items. At least once yearly, the System's investment management organizations shall provide a written evaluation based on the above-mentioned criteria. Management organizations found to be deficient relative to the System's standards may be placed on "Watch List Status" or other serious immediate necessary action may be taken which may include termination.

Specific guidelines for monitoring, evaluating, and terminating organizations managing investments for the Portfolio are included in the Statement of Investment Policy for Real Estate Investment Manager Monitoring Program – Externally Managed.

XI. RESPONSIBILITIES AND DELEGATIONS

The Portfolio shall be managed through the delegated authority issued to the Senior Investment Officer from the Board and Executive Management and may involve using consultants, investment management organizations, and Legal Counsel. Delegation of the responsibilities of each participant shall be set forth in the Real Estate Delegation & Approval Guidelines.

XII. REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT

This Policy shall be reviewed periodically to determine if modifications are necessary or desirable.

XIII. CORE AND NON CORE PORTFOLIO SUB-CLASSIFICATIONS

A. Core Portfolio

1. Investment Strategy

The Core Portfolio shall be diversified by property type and geographic region. Investments shall be limited to office, retail, industrial and apartment properties. Core Portfolio properties shall exhibit "institutional" qualities and shall be of high quality design and construction and well located within their local and regional markets. Generally, the Core Portfolio shall be well leased, although a limited portion of the Core Portfolio may be invested in properties undergoing significant re-leasing, re-development or new construction.

The Core Portfolio shall be sub-divided by investment program (e.g. Core Office Real Estate, Core Apartment Real Estate). The Investment Committee shall review and approve strategies for each investment program included in the Core Portfolio through the Annual Plan or through individual agenda items, if necessary. In addition, the Investment Committee shall adopt specific investment policies for each approved program. The existing programs within the Core Portfolio are administered and managed according to the Statement of Investment Policies attached as Appendix III.

2. Risks

There are specific risks associated with investments that shall be carefully monitored and mitigated by the System. Mitigating factors and techniques are somewhat dependent upon the individual investment program. Those risks shall be described within each investment program policy as follows:

- a. **Financial** - portfolio investments can employ a greater use of financial leverage that may lead to greater volatility in returns.
- b. **Operating and Business** - certain investments entail above average operating and business risk (e.g. hotel, and senior housing). Although primarily investments with operating and/or business risk are limited to those in the Non Core portfolio, a limited number of such investments may be undertaken in the Core portfolio subject to appropriate mitigations and commensurate investment return for the incremental risk.
- c. **Liquidity** - many investments carry an additional liquidity risk beyond the normal private market real estate investment liquidity risk (e.g. owning units of a commingled fund). Additionally, for Non Core investments, liquidation proceeds may compose the bulk of the return on investments.
- d. **Structural** - the System negotiates and structures specific fundamental rights and protections, which include mechanisms to take remedial action. These

basic protections may include advisory committee participation and specific termination provisions in partnership transactions as well as anti-dilution, put-and-call options, voting rights for material events, and other covenants and governance provisions for [direct investments](#).

3. Structures and Investment Vehicles

The Portfolio shall be implemented primarily through direct equity investments in real estate (either 100% owned or through joint ventures or other co-investment vehicles). Equity (privately-held or publicly-traded), leveraged equity, and debt instruments with equity-like features, are also appropriate structures for investments.

The System shall consider a number of different vehicles for investments including, but not limited to, the following:

- a. Equity Investments in 100% owned assets;
- b. Equity joint-ventures or other co-investment vehicles;
- c. Indirect equity investments in commingled funds; private or public REITS and corporations; limited partnerships; or other pooled investment vehicles;
- d. Private placements of equity or debt in public or private real estate operating companies; and
- e. Lower or unrated tranches of pre-existing securitized or lower structured debt instruments, such as mezzanine or other debt with equity-like features.

In choosing specific investment vehicles for Portfolio investments, consideration shall be given, but not limited to the following:

- a. Proposed investment strategy;
- b. Expected risk and return attributes of vehicles;
- c. Potential diversification benefits;
- d. Investment time horizon;
- e. Potential exit strategies and liquidity;
- f. Monitoring costs and feasibility;
- g. Tax considerations;
- h. Other incremental costs;
- i. Fee arrangements;
- j. Co-investment by Management firm and/or Partner;
- k. Potential conflicts of interest;
- l. Governance and control; and

m. Partners or co-investors.

4. Target Return and Benchmark

The Core Portfolio has a long-term target real rate of return of 5.0% (after fees) and is expected to produce market level returns over time, with a commensurate level of risk. Hence, its performance is, desired to mirror the composite NCREIF Index on before-fee basis.

5. Diversification by Geography

To reduce risk, investments in the Core Portfolio shall be predominantly located in the United States and well diversified by geography. Based on the geographic classification system used in the NCREIF Index, the Core Portfolio will be divided into four regions. Allocation ranges for the four regions are as follows:

<u>Geographic Region</u>	<u>Allocation Range</u>
West	25 - 40%
East	15 - 30%
South	15 - 30%
Midwest	10 - 25%

For the Core portfolio, international investments may be approved subject to appropriate alignment of interests; risk-adjusted returns and compliance with the Statement of Investment Policy for International Equity Real Estate (see ~~Section IX.E.~~). Core portfolio international investment is limited to 25% of the total Equity Real Estate Portfolio and investment in any one international country is limited to 10% of the total Equity Real Estate Portfolio. Core portfolio international investment is limited to 50% of the total global Core portfolio. Total international investment (Core and Non-Core Portfolios) is limited to 50% of the total Equity Real Estate Portfolio.

The distribution of states by region and division is included in Appendix II.

Additional consideration shall be given to diversification of the Core Portfolio by [Primary Metropolitan Statistical Area \(PMSA\)](#). Focus shall be placed on the primary industries supporting each metropolitan area. Generally, no more than

10% of the Core Portfolio should be located in any single Primary Metropolitan Statistical Area (PMSA).

While there are no specific guidelines for diversification based on exposure to geographies having similar economic profiles or industry concentrations or both, the Core Portfolio attempt to be prudently diversified in this aspect.

6. Diversification by Strategy

To reduce risk, the Core Portfolio shall be well-diversified by property type. Allocation ranges for the basic property types to be included in the Core Portfolio are as follows:

<u>Property Type</u>	<u>Allocation Range</u>
<u>(Expressed as a % of the Total Equity Real Estate Portfolio)</u>	
Apartment	0 - 35%
Industrial	0 - 35%
Office	0 - 35%
Retail	0 - 35%
<u>Land</u>	0 - 5%
Enhanced Core PREES	0 - <u>245%</u>

Enhanced Core Public Real Estate Equity Securities (Enhanced Core PREES), when combined with the Global~~Extended Market (Non-Core)~~ Public Real Estate Securities (Global~~Extended Market (Non-Core)~~ PREES), the total shall not exceed 245% of the Total Equity Real Estate Portfolio. Allocations between the two portfolios (Enhanced Core PREES and Global~~Extended Market (Non-Core)~~ PREES) shall be determined by the Senior Investment Officer - Real Estate.

Whenever feasible or practical, multiple-use properties, such as retail/office complexes, shall be allocated between the property type categories listed above based on investment value attributed to each use, if feasible.

Investments in Core Portfolio apartment, industrial, office, and retail properties shall be subject to the provisions set forth in the Statement of Investment Policy for Core Apartment Real Estate, Statement of Investment Policy for Core Industrial Real Estate, the Statement of Investment Policy for Core Office Real Estate and the Statement of Investment Policy for Core Retail Real Estate.

In limited instances, land may be acquired in connection with the purchase of improved property. The land may be contiguous with the improved property or in the immediate area or subdivision of the property. The land may be held if an expansion of the existing property or new development is anticipated. Separate purchases of land are also permissible provided that such acquisitions are for future development as well. In either event, direct holdings of land should not comprise more than 5% of the Total Equity Real Estate Portfolio including the Core and Non Core Portfolios but excluding the Non Core Single Family Housing sector which is governed by the Statement of Investment Policy for Single Family Housing.

The System's land holdings shall be accounted for separately from the other property type categories noted above, unless the land is undergoing development. In such cases, the land component along with development costs shall be included for performance measurement purposes in the relevant property sector component.

7. Diversification by Asset Size

For asset and risk management purposes, the Core Portfolio shall be diversified by asset size. Portfolio acquisitions shall be balanced by asset size according to the market value of the System's investment in the asset and the asset's physical size. Neither small nor large investments should dominate the composition of the Core Portfolio. The value of individual investments shall generally be no less than \$10 million and no greater than \$200 million, though exceptions can be made. In any event, no single asset should exceed 10% of the value of the Core Portfolio at any time without Senior Investment Officer approval. Smaller properties may be combined (such as a portfolio of industrial buildings) such that the aggregate investment size of the group of properties exceeds \$10 million.

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges with a reasonable timeframe. Implementation that occurs within a three-year period, with ample consideration given to preserving the

System's investment returns, is considered a reasonable timeframe.

8. Use of Leverage

Leverage is permissible in the Core Portfolio to enhance investment returns. Sufficient consideration shall be given to the impact of debt financing on the risk and return characteristics of the leveraged investments and the Core Portfolio, in total. Use of leverage shall be subject to guidelines contained in the Statement of Investment Policy Equity Real Estate Leverage.

9. Restrictions and Prohibitions

On occasion, the System may determine that certain investment strategies are not suitable. Appendix I of this Policy contains a list of prohibited investments.

B. Non Core Portfolio

1. Investment Strategy

The Non Core Portfolio consists generally of investments with expected returns in excess of the Core Portfolio and above market risk along with specifically targeted investments with generally acceptable returns. These investments are often found in "niche" opportunities (e.g., timber, hotels, and so forth) or exist because of inefficiencies in the real estate or capital markets. Additionally, the Non Core Portfolio may contain investments in special purpose properties with a narrow user market (e.g., mobile home parks). Investment strategies for the Non Core Portfolio shall be characteristically "opportunistic", based on prevailing market conditions at the time of investment. Specific policies shall be developed to take advantage of new investment opportunities as they arise. Some examples of specialized real estate investment programs include, but are not limited to, investment strategies focused on the following:

- a. Development properties;
- b. Natural resources (e.g. Timber land and Agricultural land);
- c. Urban real estate initiatives;
- d. Hotels and motels;

- e. Franchise finance net leased properties;
- f. International real estate;
- g. Senior housing;
- h. Real estate technology;
- i. Real estate private equity;
- j. Opportunistic investments; and
- k. Single family housing program.

(See Appendix IV for a list of applicable policies)

Investments shall be subject to Strategic Asset Allocation Policy and the Delegation and Approval Guidelines for Real Estate Investments, which are incorporated by reference hereto.

2. Risks

There are specific risks associated with investments that shall be carefully monitored and mitigated by the System. Mitigating factors and techniques are somewhat dependent upon the individual investment program. Those risks shall be described within each investment program policy as follows:

- a. **Financial** - portfolio investments can employ a greater use of financial leverage that may lead to greater volatility in returns.
- b. **Operating and Business** - certain investments entail above average operating and business risk (e.g. hotel, and senior housing). Although primarily investments with operating and/or business risk are limited to those in the Non Core portfolio, a limited number of such investments may be undertaken in the Core portfolio subject to appropriate mitigations and commensurate investment return for the incremental risk.
- c. **Liquidity** - many investments carry an additional liquidity risk beyond the normal private market real estate investment liquidity risk (e.g. owning units of a commingled fund). Additionally, for Non Core investments, liquidation proceeds may compose the bulk of the return on investments.

- d. **Structural** - the System negotiates and structures specific fundamental rights and protections, which include mechanisms to take remedial action. These basic protections include advisory committee participation and specific termination provisions in partnership transactions as well as anti-dilution, put-and-call options, voting rights for material events, and other covenants and governance provisions for direct investments.

3. Structures and Investment Vehicles

The Portfolio shall be implemented primarily through direct equity investments in real estate (either 100% owned or through joint ventures or other co-investment vehicles). Equity (privately-held or publicly-traded), leveraged equity, and debt instruments with equity-like features, are also appropriate structures for investments.

The System shall consider a number of different vehicles for investments including, but not limited to, the following:

- a. Equity Investments in 100% owned assets;
- b. Equity joint-ventures or other co-investment vehicles;
- c. Indirect equity investments in commingled funds; private or public REITS and corporations; limited partnerships; or other pooled investment vehicles;
- d. Private placements of equity or debt in public or private real estate operating companies; and
- e. Lower or unrated tranches of pre-existing securitized or lower structured debt instruments, such as mezzanine or other debt with equity-like features.

In choosing specific investment vehicles for Portfolio investments, consideration shall be given, but not limited to the following:

- a. Proposed investment strategy;
- b. Expected risk and return attributes of vehicles;
- c. Potential diversification benefits;
- d. Investment time horizon;
- e. Potential exit strategies and liquidity;
- f. Monitoring costs and feasibility;
- g. Tax considerations;
- h. Other incremental costs;
- i. Fee arrangements;

- j. Co-investment by Management firm and/or Partner;
- k. Potential conflicts of interest;
- l. Governance and control; and
- m. Partners or co-investors.

4. Target Return and Benchmark

The Non Core Portfolio shall be expected to achieve a minimum, long-term real rate of return that generally exceeds the Core Portfolio (a target real rate of return exceeding 5%) and may be reflective of higher levels of risk, often characteristic of its constituent investments, as appropriate. Within the Non Core Portfolio, expected returns may vary considerably, based on differences in investment program strategies and structures, and the level of risk associated with each program, among other factors. Additionally, investments included in the Non Core Portfolio are likely to generate limited current income. The bulk of the return on these investments is expected to come from value creation or appreciation. Some programs may employ moderate-to-high levels of leverage to augment investment performance (e.g., Single Family Housing Development).

The performance of the Non Core investments may be compared to U.S. equity real estate benchmarks (the NCREIF or WRESI indices) or other appropriate benchmarks and target returns in excess of the minimum 5% overall real return objective for the Core portfolio. When appropriate, customized benchmarks shall also be developed for these investments, taking into account specific risk attributes of the investments, (e.g. the international and timber sectors.)

5. Diversification by Geography

Capital allocations shall be primarily driven by market opportunities. The System shall seek to maintain a prudent level of diversification within and among such investments. Care shall be given to avoid undue concentrations in any one particular investment strategy.

International investment is allowed in The Global PREES portfolio.

Investment is allowed in commingled funds which contain strategies to invest up to 25% of the fund in countries not included on CalPERS' Permissible Equity Markets List.

Non Core Portfolio international investment in any one international country is limited to 10% of the total Equity Real Estate Portfolio.

Total international investment (Core and Non-Core Portfolios) is limited to 50% of the total Equity Real Estate Portfolio.

Non Core Portfolio international investment shall comply with the Statement of Investment Policy for International Equity Real Estate.

6. Diversification by Strategy

To reduce risk, the Non Core Portfolio shall be well-diversified by property type. Allocation ranges for the basic property types to be included in the Non Core Portfolio are as follows:

Property Type	Allocation Range
<u>(Expressed as a % of the Total Equity Real Estate Portfolio)</u>	
Natural Resources (Timber & Agricultural land)	0-15%
California Urban Real Estate (CURE)	0-30%
Franchise Finance	0-15%
International	<u>0-215%</u>
Senior Housing	0-15%
Single Family Housing Program	0-30%
GlobalExtended Market (Non Core) Public Real Estate	
Equity Securities (GlobalExtended Market (Non Core)	
PREES)	<u>0-215%</u>
Opportunistic Real Estate	0-15%

~~GlobalExtended Market (Non Core)~~ Public Real Estate Equity Securities (~~GlobalExtended Market (Non Core)~~ PREES) when combined with the Enhanced Core Public Real Estate Securities (Enhanced Core PREES), the total shall not exceed 215% of the Total Equity Real Estate Portfolio. Allocations between the two portfolios (~~GlobalExtended Market (Non Core)~~ PREES and Enhanced Core PREES) shall be determined by the Senior Investment Officer – Real Estate.

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges with a reasonable timeframe. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable timeframe.

As investments in the Portfolio mature, their characteristics may migrate towards a more Core-like profile. The Real Estate Consultant or Staff or both shall monitor the Equity Real Estate Portfolio for instances when changes in the classification of investments from the Non Core portfolio to the Core Portfolio are warranted. The Consultant or the Real Estate Unit or both shall inform the Investment Committee for approval of such reclassifications.

7. Diversification by Asset Size

The size of Portfolio investments shall depend on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. Furthermore, investment size shall be appropriate to the projected risk versus return level of the investments. However, in order to have some effect on the composite Equity Real Estate Portfolio, preference shall be given to investments with funding commitments of \$50 million (or greater) in size.

8. Use of Leverage

Moderate to high use of leverage is permissible in the Non Core Portfolio to enhance investment returns. Sufficient consideration shall be given to the impact of debt financing on the risk and return characteristics of the leveraged investments and the Core Portfolio, in total. Use of leverage shall be subject to guidelines contained in the Statement of Investment Policy Equity Real Estate Leverage as well as within the contractual agreements of each program.

9. Restrictions and Prohibitions

On occasion, the System may determine that certain investment strategies are not suitable. Appendix I of this Policy contains a list of prohibited investments.

XIV. GLOSSARY OF TERMS

Definitions for key words used in this policy are located in the Real Estate Glossary of Terms which is included in the System's Master Glossary of Terms.

Appendix I**Prohibited Investments**

Any investment prohibited by the System's Insider Trading Policy and Restricted Company list.

Appendix II**Distribution of States by NCREIF Regions and Sub-regions**

West Region	Midwest Region	East Region	South Region
<u>Mountain</u> <i>Arizona</i> <i>Colorado</i> <i>Idaho</i> <i>Montana</i> <i>Nevada</i> <i>New Mexico</i> <i>Utah</i> <i>Wyoming</i>	<u>East North Central</u> <i>Illinois</i> <i>Indiana</i> <i>Michigan</i> <i>Ohio</i> <i>Wisconsin</i>	<u>Northeast</u> <i>Connecticut</i> <i>Maine</i> <i>Massachusetts</i> <i>New Hampshire</i> <i>New Jersey</i> <i>New York</i> <i>Pennsylvania</i> <i>Rhode Island</i> <i>Vermont</i>	<u>Southeast</u> <i>Alabama</i> <i>Florida</i> <i>Georgia</i> <i>Mississippi</i> <i>Tennessee</i>
<u>Pacific</u> <i>Alaska</i> <i>California</i> <i>Hawaii</i> <i>Oregon</i> <i>Washington</i>	<u>West North Central</u> <i>Iowa</i> <i>Kansas</i> <i>Minnesota</i> <i>Missouri</i> <i>Nebraska</i> <i>North Dakota</i> <i>South Dakota</i>	<u>Mideast</u> <i>Delaware</i> <i>District of Columbia</i> <i>Kentucky</i> <i>Maryland</i> <i>North Carolina</i> <i>South Carolina</i> <i>Virginia</i> <i>West Virginia</i>	<u>Southwest</u> <i>Arkansas</i> <i>Louisiana</i> <i>Oklahoma</i> <i>Texas</i>

Appendix III

Policy List for Core Portfolio Investment Programs

Statement of Investment Policy for Equity Real Estate
Statement of Investment Policy for Equity Real Estate - Accounting Policy
Statement of Investment Policy for Equity Real Estate Appraisal and Valuation
Statement of Investment Policy for Equity Real Estate Joint Ventures
Statement of Investment Policy for Equity Real Estate Leverage
Statement of Investment Policy for Hazardous Materials in Real Estate Investments
Statement of Investment Policy for Real Estate Development
Statement of Investment Policy for Real Estate Hybrid Debt Investments
Statement of Investment Policy for Real Estate Investment Manager Monitoring Program -
Externally Managed
Statement of Investment Policy for Real Estate Sale-leaseback
Statement of Investment Policy for Responsible Contractor Program

Statement of Investment Policy for Core Apartment Real Estate
Statement of Investment Policy for Core Industrial Real Estate
Statement of Investment Policy for Core Office Real Estate
Statement of Investment Policy for Core Retail Real Estate
Statement of Investment Policy for Enhanced Core Index Public Real Estate Equity Securities
(Enhanced Core PREES)
Statement of Investment Policy for International Equity Real Estate

Appendix IV

Policy List for Non Core Portfolio Investment Programs

Statement of Investment Policy for Equity Real Estate
Statement of Investment Policy for Equity Real Estate - Accounting Policy
Statement of Investment Policy for Equity Real Estate Appraisal and Valuation
Statement of Investment Policy for Equity Real Estate Joint Ventures
Statement of Investment Policy for Equity Real Estate Leverage
Statement of Investment Policy for Hazardous Materials in Real Estate Investments
Statement of Investment Policy for Real Estate Development
Statement of Investment Policy for Real Estate Hybrid Debt Investments
Statement of Investment Policy for Real Estate Investment Manager Monitoring Program –
Externally Managed
Statement of Investment Policy for Real Estate Sale-leaseback
Statement of Investment Policy for Responsible Contractor Program

Statement of Investment Policy for Agricultural Land Real Estate Investment
Statement of Investment Policy for California Urban Real Estate
Statement of Investment Policy for Extended Market Public Real Estate Equity Securities
(Extended Market PREES)
Statement of Investment Policy for Franchise Finance Real Estate
Statement of Investment Policy for International Equity Real Estate
Statement of Investment Policy for Senior Housing Program
Statement of Investment Policy for Single Family Housing Program
Statement of Investment Policy for Timber Real Estate
Statement of Investment Policy for Opportunistic Real Estate